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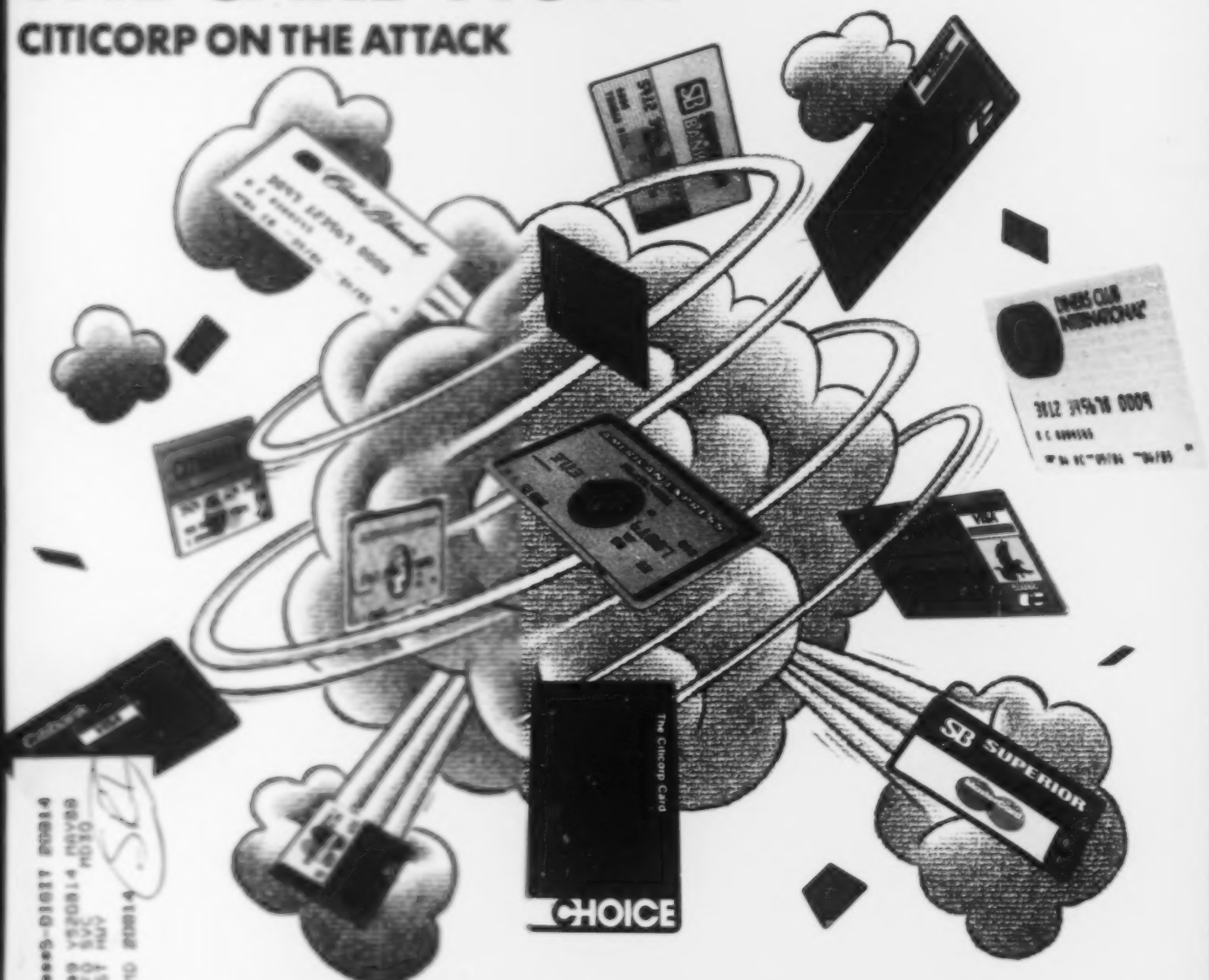
FORTUNE

THE CARD FIGHT

CITICORP ON THE ATTACK



PROCTER & GAMBLE'S COMEBACK PLAN

HOW TO SELL BY LISTENING

THE BOOM IN DATABASES FOR PCs

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THE GREAT PLASTIC

A lot of corporations think the key to the financial future is made of plastic, and Citicorp is attacking fellow giants in a big-money battle to find it. Cards may not be as powerful as some think, but they sure can be profitable.

■ *by Monci Jo Williams*

REMEMBER the fellow in *The Graduate* who whispered to Dustin Hoffman that plastic was the wave of the future? Corporate planners have bought the idea. Some giant American companies are betting that plastic, the kind people carry in their wallets, is about to become the ultimate strategic weapon. The biggest believer appears to be John Reed, 45, who became chief executive of Citicorp last September.

Reed has a full arsenal of cards at his disposal and, according to card-industry tracker Spencer Nilson, probably spent $150 million to $200 million last year to promote them. Some of the money went into nationwide marketing of MasterCard and Visa, both owned by bank cooperatives and also issued by thousands of other U.S. banks. But Citicorp really shelled it out for some of the proprietary cards in its silos. These include such familiar names as Diners Club and Carte Blanche—used mostly for travel and in restaurants—and a new advanced weapon, the Choice card, that is already held by a million Americans. Though little known outside states where the card is marketed—and Citi's home state of New York isn't one of them—Choice has the competition's radar blipping.

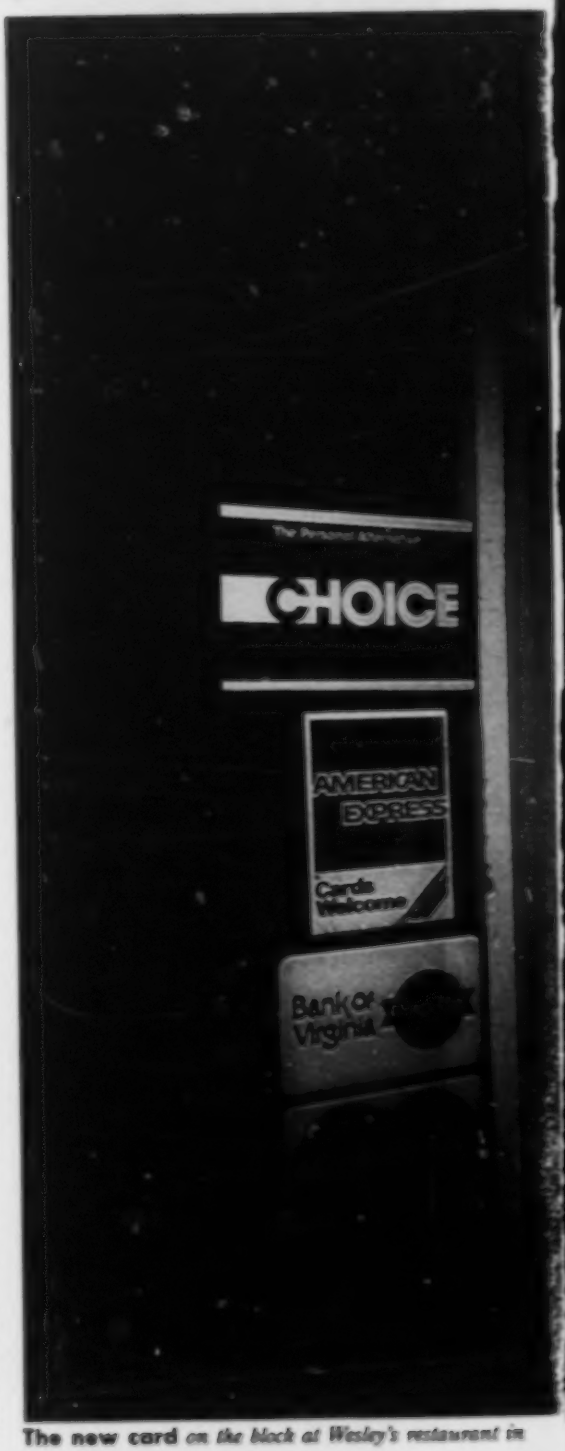
Reed's moves are part of his strategy to make Citi the first and foremost nationwide bank. Other card players have different goals, but all are trying to figure ways to reach the right consumers or investors, to persuade them to use their cards to do more things, or to cross-sell other products or services. Banks and nonbanks are doling out money for hardware and software so they can defend their positions, or advance them, as the nation moves to electronically based payment systems. The upshot is that plastic is about to become a battleground in a fight for turf.

Plastic may not prove as powerful as Reed and others hope, but it can be immensely profitable. At the moment, credit cards are a bright spot for beleaguered banks. Banks charge annual interest rates of anywhere from 13% to 22% for unpaid balances on Visa and MasterCards they issue—vs. 10.75% on loans made at the prime rate—plus an average annual fee of $17 per card. Banks also do a nice business processing credit transactions for merchants, traditionally those near their home turf, usually raking off 2% to 3.5% of total charges; they typically pass along 1.5 percentage points to the bank that issued the card.

American Express gets most of its card revenues by processing every single American Express receipt itself, a paperwork feat for which it charges merchants 3% to 5% of billings. Its annual card fees—$35 for the green card, $65 for the gold—comfortably exceed $650 million. Rodney Schwartz, a security analyst at PaineWebber, estimates that American Express netted $252 million from the card business in 1984, 42% of total corporate profits.

WITH 15 MILLION U.S. cardholders, American Express virtually owns the so-called travel and entertainment market. But it frets about Citi, which is spending heavily to steal business for Diners Club, and about some other powerhouses that are experimenting with card tricks. Among these is Sears Roebuck, with 60 million cards. How long, the card watchers wonder, will Sears be content to let its cards languish out there, underutilized, equipped only to make a Sears purchase? How long before Sears develops a multiple warhead?

Sears won't comment about its plans, nor will Citicorp. But it is a safe bet that none of the cardplayers feel secure. The sheer might of the competition is not the only worry. Deregulation of banking is sure to make doing business tougher; any company with lots of

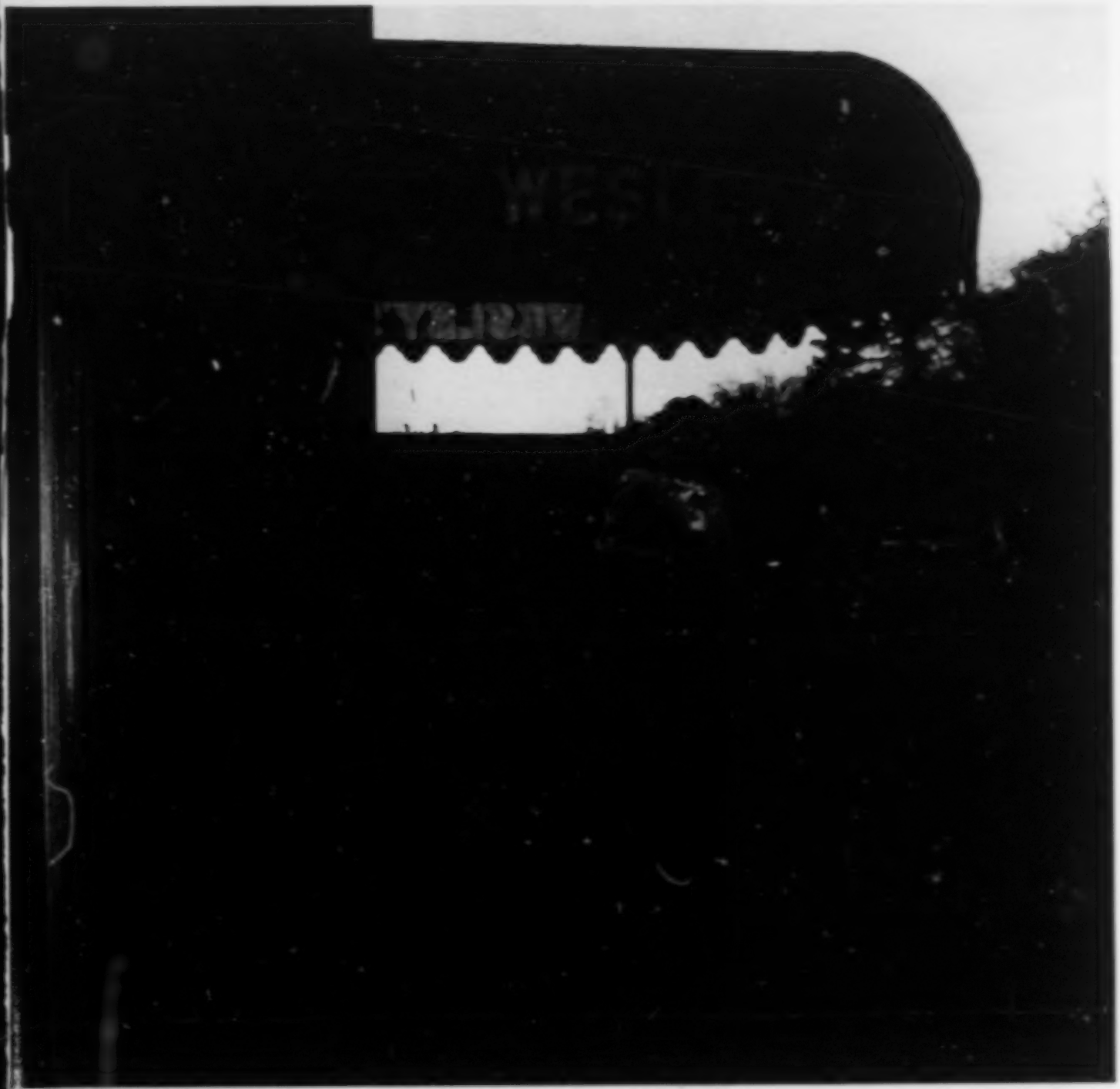


The new card *on the block at Wesley's restaurant in*

PHOTOGRAPH BY BILL BALLENBERG

RESEARCH ASSOCIATE *David Kirkpatrick*

CARD FIGHT BEGINS



Virginia Beach, Virginia, is Citicorp's Choice. Citi now offers it in just a few states, but plans to go nationwide.

cardholders and processing power is a potential threat; and technology could dramatically alter the way payments are made. Banks are promoters of debit cards, but they have mixed feelings about the trend toward electronic debiting in retail stores—paying for purchases with almost instantaneous withdrawals from bank accounts (see box). As a system of payment, bankers prefer debit cards to checks, which are generally unprofitable to process. But what if debit cards begin to take the place of credit cards? This not only would threaten those profitable credit card loans, it would reduce what merchants pay banks for processing card purchases. In fact, a couple of pioneering retailers, Mobil Oil and Publix Super Markets in Florida, have invested in the hardware and software necessary to accept debit cards and, for providing the systems, are *charging some banks to make the transactions.*

With fast-moving technologies and deregulation blurring everybody's vision of the financial future, practically any articulate seer's scenarios seem plausible. Not to react seems unthinkable, so all the participants are doing something, often at great cost. It may be decades before the corporate winners are known, but in the meantime the battle should benefit every card-carrying consumer.

REED is counting on his portfolio of plastic to establish a strong national consumer franchise for Citicorp. The plan is to place millions of cards bearing Citi's name in the hands of consumers all over the U.S. and then to cross-sell those cardholders mortgages, student loans, credit life insurance, and maybe even stocks and bonds. More important, Reed also aims

JOSS BAUGHMAN—BLACK STAR

Citi's John Reed *has an arsenal of cards.*

to attract deposits this way, particularly CDs and money market accounts, by offering attractive rates or services. In short, Reed will use cards to help him make an end run around federal restrictions on interstate banking—by setting up a national banking network through the mail.

To attract rich customers, Citi has been spending much of its money lately promoting "prestige" cards. It has embarked on a huge campaign to issue Visa's Premier card, which Citibank calls Preferred Visa. And in the last two years Citi has poured at least $70 million into Diners Club, a weakling in the travel and entertainment (T&E) market when it was acquired in 1981 and probably still a money loser in the U.S. The push to resuscitate the card began in earnest in 1983, directed by Richard S. Braddock, 43, Citicorp's top card executive. Until he joined the bank in the mid-1970s, Braddock had been a marketing man at General Foods, but Diners is not a piece of cake.

Citicorp's first task is to unsell consumers on the American Express card, which got its grip on the T&E market by convincing people that they can't leave home without it. Citi may have underestimated the difficulty of building up a base of cardholders and establishments willing to accept the card. It's a slow, expensive, brick-by-brick sort of task: consumers don't want a card if it isn't widely accepted by merchants, and merchants don't want to bother accepting a card that doesn't bring with it a lot of affluent card carriers. Though Diners is outnumbered two million to 15 million by American Express in the U.S., the numbers look better abroad, where Diners has three million cardholders to American Express's five million. Until recently the Diners operations outside the U.S. were owned by franchisees, a different one in each country. For the last couple of years Citicorp has been busily buying those franchises. But almost nobody thinks Diners can catch American Express.

Citi's solution to the almost Sisyphean task at hand has been to buy its way in the market, using every marketing trick in the book. Last year Citi began a direct-mail blitz for Diners, soliciting thousands of "preferred customers"—business travelers whose names Citi probably bought from the rosters of airline frequent-flier programs. "Frankly, Citicorp Diner's Club wants your business, and we're willing to work for it!" the mailer began. But preferred customers who read on found that Citi wasn't just willing to work for their business, it was willing to pay for it. Citi offered all sorts of lavish incentives along with the card, among them a credit toward the first $25 in charges, free Citicorp traveler's checks, and a round-trip ticket on American Airlines to anywhere in the U.S., including Hawaii, or to the Virgin Islands, for a mere $175.

Those kinds of incentives have doubtless produced results, though one wonders what will happen if the incentives are no longer offered when the card comes up for renewal at $45 a year, $10 more than American Express's green. Citi hopes to pick up cardholders faster by going after corporate customers, who would furnish Diners cards to their executives in bulk. Citi kicked off its ad campaign last year using the tag line "Citi-

INVESTOR'S SNAPSHOT

CITICORP

ASSETS (AS OF 9/30/84)	**$144.7 BILLION**
CHANGE FROM YEAR EARLIER	UP 11%
NET PROFIT (LATEST FOUR QUARTERS)	**$830.0 MILLION**
CHANGE	DOWN 3%
RETURN ON COMMON STOCKHOLDERS' EQUITY	**14%**
FIVE-YEAR AVERAGE	14%
RECENT SHARE PRICE	**$37.50**
PRICE/EARNINGS MULTIPLE	**6**
TOTAL RETURN TO INVESTORS (12 MONTHS TO 12/31/84)	**11%**
PRINCIPAL MARKET	**NYSE**

Explanatory notes: page 126

INVESTOR'S SNAPSHOT

AMERICAN EXPRESS

ASSETS (AS OF 9/30/84)	**$62.8 BILLION**
CHANGE FROM YEAR EARLIER	UP 69%
NET PROFIT (LATEST FOUR QUARTERS)	**$418.0 MILLION**
CHANGE	DOWN 40%
RETURN ON COMMON STOCKHOLDERS' EQUITY	**10%**
FIVE-YEAR AVERAGE	18%
RECENT SHARE PRICE	**$36**
PRICE/EARNINGS MULTIPLE	**19**
TOTAL RETURN TO INVESTORS (12 MONTHS TO 12/31/84)	**20%**
PRINCIPAL MARKET	**NYSE**

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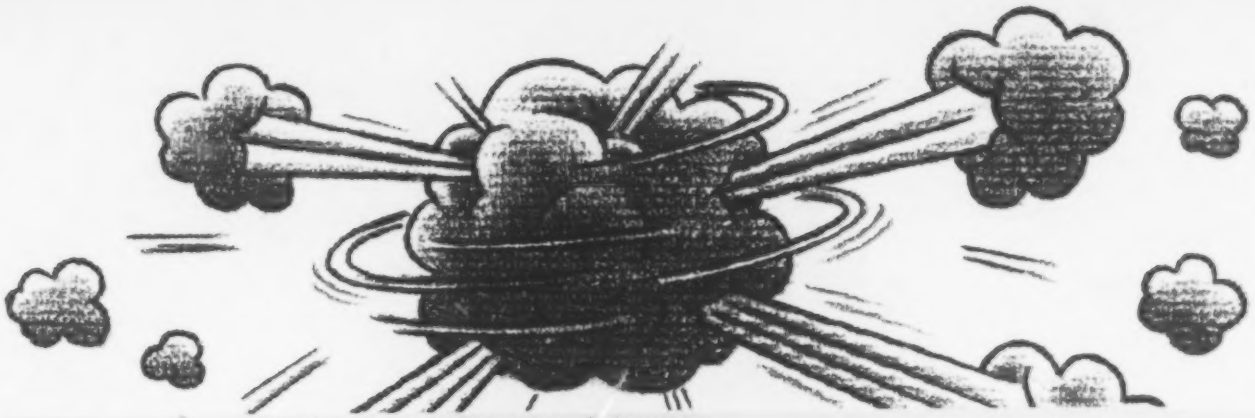

CARD	ISSUED IN THE U.S.	BILLINGS ON CARD IN 1984 in billions*	COMMENTS
VISA	77,200,000	$60.6	Issued by banks. Banks issuing 25 million cards participate in Visa's automated teller network enabling cardholders to get cash at 1,564 machines in 25 states. A few banks also issue Visa Electron debit cards, which can be used at ATMs and to pay for purchases at 25 test retail locations by debiting the holder's bank account.
MASTERCARD	60,000,000	$49.7	Issued by banks. Nine million cardholders can get cash at 3,000 ATMs in 28 states. A new card for electronic debiting at supermarkets and gas stations will be announced in February.
AMERICAN EXPRESS	15,000,000	$36.6	Three million cardholders participating in the Express Cash system can withdraw cash from their checking accounts at 2,000 ATMs in 31 states.
SEARS	60,000,000	$13.6	Usable only to charge purchases from Sears Roebuck.
Issued by CITICORP			
Visa & MasterCard	6,000,000	$ 6.8	Diners and Carte Blanche are wholly owned by Citicorp. Choice is a combination credit/debit card owned by Citicorp and issued primarily in Maryland, Virginia, the District of Columbia, and Colorado. Cardholders use it to make payments either from their credit line or from bank deposits. Citibank participates in networks across the U.S. that enable holders of Choice to get cash at over 1,000 ATMs.
Diners Club	2,200,000	$ 4.9	
Carte Blanche	300,000	$ .4	
Choice	1,000,000	$ .7	

*Estimated by the *Nilson Report* newsletter.

ILLUSTRATION BY MICHAEL BARTALOS

Players in the High-Stakes Card Game

Though there are more Visa cards in Americans' wallets than any other brand, Sears Roebuck is the biggest single card issuer. MasterCards and Visa cards are issued by thousands of U.S. banks, including Citicorp, which is heavily promoting competing cards of its own.

corp Diners Club . . . when you mean business." The ads and TV spots featured four companies that used Diners as their corporate T&E card. Top officers of two of them—United Technologies and Corning Glass Works—are directors of Citicorp.

THE CORPORATE MARKET is also the segment that American Express has been planning to cultivate next, and the clash promises to be lively. American Express has surprised everyone, including American Express, with its success at expanding its cardholder base in other areas. The man who deserves most of the credit is Louis V. Gerstner, 42, chairman of the executive committee at American Express and head of the subsidiary that operates the card and travel services.

When Gerstner arrived in 1978 from McKinsey & Co., the management consulting firm, security analysts were saying that American Express's card business had reached maturity. The cards, they reasoned, were already in the hands of practically all the traveling executives who needed them, and they were accepted by most airlines, car-rental companies, hotels, and good restaurants. Since then, Gerstner has managed to keep earnings in the card business growing at an annual average rate of 25%, compounded. He discovered women, raising the proportion of female card members to 29% of the total from 16% four years ago, and he began adding graduating college students to the card-member base. He also went after retail stores, not previously hustled, and got merchants from Saks Fifth Avenue to the Gap to accept the card.

The trade-off for taking on new groups of cardholders was that the green card lost some of the cachet that went with a more exclusive approach. Gerstner, who believes that snob appeal sells, pushed the gold card hard to hold customers who otherwise might have been lured away by the Visa Premier card or MasterCard's gold model. Last year he introduced the platinum card, available only to people who have charged more than $10,000 on their American Express cards in the past year. So far it turns out that 50,000 of these big spenders are willing to fork over $250 to carry plastic platinum.

Gerstner is just beginning his push into the corporate market. The company has sold only about two million corporate cards, most of them to small businesses. Now American

Express is aiming at large corporate accounts among the FORTUNE 500. Gerstner thinks the corporate segment could grow by more than 50% a year, and he doesn't intend to share that growth with Citicorp or anyone else.

JERRY C. WELSH, a former head of card marketing and now in charge of worldwide marketing and communications for Gerstner's subsidiary, claims that American Express will "clean Citibank's clock" in the corporate card segment with a product called Travel Management Service, or TMS. The product is an integrated package of corporate services wrapped around the basic American Express card. The services include analyzing travel and entertainment costs by division, consulting with companies about travel policies, and actually operating as the travel department for companies that don't have their own. Gerstner's pitch is that TMS will help U.S. corporations control the $80 billion or so they spend on travel and entertainment for employees each year.

While Citicorp tangles with American Express in the corporate market, it is already well along in an experiment with the Choice card to find out whether it can collect deposits by mail. Back in 1977, when Reed was head of Citi's fledgling retail banking unit, Citicorp bought NAC, a small Baltimore-area charge card, and renamed it Choice. The bank did little with the card until 1980, when it reintroduced Choice in Baltimore. Now Choice is distributed mainly in the Baltimore-Washington area and in Colorado. The million cardholders have 60,000 places to use the card.

Last year Choice customers charged an estimated $700 million on their cards. Though that is small potatoes in the card game (see table), Choice has performed impressively in the Baltimore-Washington area, where the test began. Ronald E. Geesey, president of the Citicorp subsidiary that markets the card, told a group of security analysts last year that in 1983 Choice accounted for more than 25% of sales by "major retailers" in that market—more than American Express (16%) and MasterCard (23%) and just a nose behind Visa (28%). As it has with Diners Club, Citi has equipped the card with all sorts of appealing features to get it into consumers' hands and to get them to use it. Cardholders receive Choice and an accompanying credit line of $750 to $5,000 without paying an annual fee, and are promised a rebate of 0.5% on all Choice purchases above

JOHN LOCHER

Card boss Louis Gerstner *of American Express is doing battle with Diners Club.*

the first $600 in any 12-month period. To find out whether consumers would hand over deposits through the mail, Citi has outfitted Choice with several interest-paying accounts. For deposits larger than $1,000, Choice was recently paying 10%, more than a point above prevailing money market rates. Cardholders who overpay their bills by less than $1,000 get 5.25%.

When Choice moved to Denver in 1983, it found an ideal test market. Colorado allows out-of-state bank holding companies to open limited-service banks that can collect consumer deposits, and it also requires banks in automated teller networks to share their terminals with other state banks. So in Colorado, through Citicorp Industrial Bank, Choice cardholders can get cash and make deposits at hundreds of ATMs around the state.

It's hard to get a fix on how much Citi has collected in deposits from Choice customers, since the bank isn't talking. But Citi must be encouraged by Choice's early returns. Last spring Geesey told the analysts that Choice had "a great future," adding that if the results of the Baltimore test could be duplicated nationwide, "we are talking about tens of millions of cardholders." Several months later, after it successfully petitioned Maryland legislators to pass a bill allowing out-of-state bank holding companies to set up shop in their state, Citicorp opened a Maryland banking subsidiary. Its purpose, Citi told shareholders last November, is to provide a launching pad from which "to market our Choice card nationwide . . . through mail and telephone marketing." Perhaps in anticipation of the rollout, Citi has recently signed up ATM networks in several states—including Florida, Texas, and California—at which Choice cardholders can get cash.

Citicorp was able to expand Choice's merchant base from Maryland and Washington, D.C., through Delaware, Virginia, North Carolina, and southern Pennsylvania by using the economies of scale in its huge credit card processing operations. To get into Virginia, Citi started a price war. Through what it called a "tri-card plan," it offered to process merchants' credit slips for Visa, MasterCard, and Choice for about half a percentage point below the approximately 3% charged by banks in the area. Randolph Wyckoff, a senior vice president in charge of credit cards at the Bank of Virginia, says he lost plenty of processing business to Citicorp. In fact, says Wyckoff, "they kicked our ass all over the block."

To protect the business he had left, Wyckoff went to Citicorp and offered to sell the Choice card to the merchants whose Visa and MasterCard slips he processed. Citi agreed, and the United Virginia Bank and Central Fidelity, two other Richmond-based banks, soon struck similar deals.

THERE WAS some growling from other banks in the state, since nobody in Virginia has much appreciation for Yankee invasions. "Sure they asked me, 'Why'd you let 'em in?' " drawls Wyckoff. "But what else are you gonna do? You can try to hold the door as long as you can—and then when it opens, it squashes you. Or you can try to find an advantage."

More companies may soon be trying to beat down the door. If Citi can make headway across the U.S. in spite of regulations that make it hard to leave the state, why can't big retailers with cross-country electronic networks for authorizing and processing

credit purchases launch their own all-purpose credit cards? And for that matter, if the retailers happen to own banks or savings banks—as Sears does in California and both Sears and J.C. Penney do in Delaware—why can't they collect deposits the same way Citi hopes to?

Bankers say that Sears is testing the idea of an all-purpose credit/debit card like Choice that could be used at automated teller machines. And Sears is also looking for ways to link its card to its securities subsidiary, Dean Witter. In San Diego, Sears is experimenting with a card that gives some customers of Dean Witter and Sears Savings Bank access to cash at automated teller machines throughout California.

BANKERS and others take comfort from the thought that Sears would have trouble launching a nationwide credit card because other retailers would resist accepting a competitor's plastic. But Sears has been working on a deal with a noncompeting retailer, Phillips Petroleum. In a test, Phillips has been using Sears' sophisticated electronic network to check the credit of customers using cards and to process credit purchases. Penney has been marketing its electronic network through a subsidiary set up in 1983 called J.C. Penney Systems Services. Among its customers are Shell Oil and Gulf Oil, which pay Penney 10 cents to 13 cents per transaction to do what Sears is doing for Phillips. Late last year Penney even signed up a bank in Utah, which uses Penney's network to transmit data for its own bank-card operations. And just to scramble your senses, a 75%-owned subsidiary of American Express, called First Data Resources, thinks it is the largest nonbank processor of Visa and MasterCard transactions in the U.S. The possible permutations suggested by all this, combined with the prospect of electronic debiting at the cash register, justify bankers' fears that nonbanks may wrest control of the payment systems.

Before the technology gets sorted out, and before Reed's great experiments prove anything, consumers must cast their votes. Do they really want a card that can zap their bank account to pay for things? Can deposits be coaxed from them, by mail or any other way, or will they coolly shop for the best rate? Do they like the idea of one-stop financial services, or is that just a planner's dream? Will corporations buy charge cards? Will people come to favor some new brand of card over the ones we already have? Strategists can only guess at the answers, but there will be winners among those who are willing to place their bets before all the answers are clear. ■

DEBIT CARDS GO SHOPPING

■ If you are laboring under the impression that you have never seen a debit card, take a look at the piece of plastic that goes in your bank's automated teller machines. It's a debit card, meaning it can electronically siphon money out of your bank account. It could do that at electronic terminals thousands of miles from your bank's ATMs if the terminals existed and if your bank was linked to them. Some do exist, and more are on the way. Many of the 60,000 ATMs around the U.S. are linked into statewide, regional, or national networks owned by groups of banks.

A PIN number *identifies a shopper using a debit card at a Florida beachwear store.*

Having invested a bundle on hardware and software, the bank-owned networks need to handle more transactions to make electronic debiting profitable. The easiest way, and one the banks are pushing, is to put terminals into stores where ATM cards could be used at the cash register to debit bank accounts of participating banks. So-called point-of-sale debiting has been slow arriving, but it has won some fans outside banking.

Merchants generally approve of debit cards. Retailers get their money almost immediately when a purchase is made, and since it goes to their bank account rather than their cash registers, it is holdup-proof. Some say debit cards are the fastest way to buy things, but others are skeptical because purchasers have to verify their identity, usually by punching a personal identification number (PIN) onto a "PIN pad." Retailers will almost certainly spend less to have debit card transactions processed than they now pay banks to process credit cards and checks.

In a turn of the tables, Publix, an innovative $3-billion-a-year Florida supermarket chain, is charging banks to make transactions. Publix invested $11 million of its own money to install 314 automated teller machines in its stores, and will invest another $9 million to wire its checkout lanes with point-of-sale terminals by the end of the year. For providing the systems, it charges banks 40 cents on ATM withdrawals and will take 15 cents for each point-of-sale transaction. Also, Publix estimates it saved about $750,000 in check-processing costs—which run about 20 cents to 30 cents per check.

But do consumers need a new way to pay? Why not keep their money at work earning interest while their checks lumber through the cumbersome settlement process, or wait until the interest meter starts ticking to pay for credit purchases?

Mobil, which has also built a point-of-sale debit system, found an inducement: it offers debit card purchasers the same 4-cents-a-gallon discount it gives for cash. By far the largest point-of-sale operation in the country, Mobil has 1,000 terminals at high-volume gas stations, and it plans to more than double the number this year.

Walter D. Manz, a Mobil marketing manager, believes that Mobil stations may handle half the debit transactions conducted daily in the U.S. Even so, the number is well below Mobil's projections. "There is a big consumer education effort involved in starting up a new payment mechanism," says Manz. Mobil kicked off its debit network with promotions that included radio commercials, newspaper ads, and direct-mail inserts with discount coupons worth $1 and $2 on debit purchases. Manz says that offering a new way of paying brought new customers into the station.

Presumably they were people who liked discounts but didn't have cash. There could be lots more like that.

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FORTUNE

AMERICA'S NEW ABSTINENCE

SELLING TO THE LIGHT-DRINKING, LIGHT-SMOKING, LOW-CAL GENERATION

MERCK'S TROUBLESOME ACQUISITION IN JAPAN

CRAY'S SEARCH FOR THE SUPER-DUPER COMPUTER

WHO'S WINNING IN THE OPTIONS BOOM

SK21

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Matthew Klein's cover photo evokes the watery start of a business lunch in newly abstinent America. See page 20.

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AMERICA'S NEW ABSTINENCE

The light-drinking, light-smoking, low-cal generation is bad news for some big businesses. But the trend isn't monolithic, and no two industries face the same challenges. Smart marketing executives are finding that even fitness fiends respond to a skillful spiel. ■ *by Stratford P. Sherman*

LED BY maturing baby-boomers and fitness fiends, Americans are breakfasting on less bacon and fewer eggs, forgoing the lunchtime Scotch, and seeing a lot more sparkling water and chicken breasts at dinnertime. The new abstinence has touched the lives of so many people that it is creating havoc in some very large industries. For marketers of products spurned, or favored, by increasingly health-conscious Americans, abstinence is either a problem of historic proportions or a magnificent opportunity.

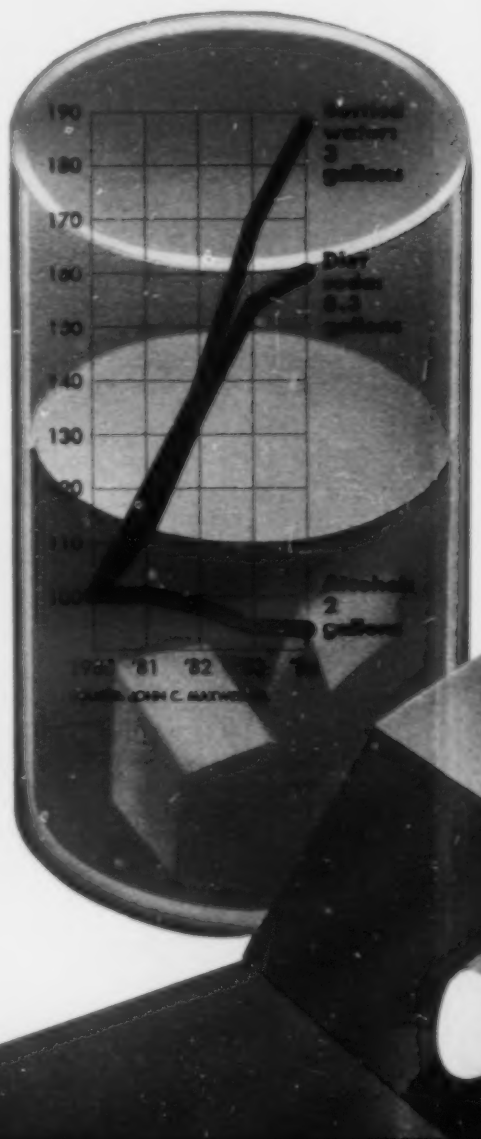
The trend isn't monolithic, or in some cases even rational. Fitness is certainly in fashion, but so once were Beatle wigs and contempt for material possessions. No two industries face the same challenges and opportunities. Concerns about cholesterol and obesity, for example, have apparently induced consumers to eat fewer eggs and to swill diet soda by the vatful. Yet the candy business is booming, and sales of cheese, a product notably high in fat and cholesterol, are going through the roof. After all, eating Brie with the rind sliced off is among the most essential tokens of yuppiedom.

When it strikes, the new abstinence can prematurely force some hitherto growing markets to behave like mature ones. Consumers suddenly cut back, an industry's growth slows or stops, and companies find themselves scrambling for market share. This is a game in which the big players often do best because they have the financial resources and the marketing clout to reach out to narrower segments of the market. In cigarettes, beer, and a host of other industries, more of the sales dollar is going to product development, packaging and promotion of new brands, and advertising. Yet the same strategies don't work for all embattled products. Philip Morris, for example, is succeeding in cigarettes and flunking in beer and soft drinks (see following story).

One haven of growth in some suffering industries is the high-priced end of the market. Savvy marketers recognize that the yuppies who are leading the fitness trend are also often status-conscious and predisposed to buy top-of-the-line products. While beer sales are declining, the pricey and prestigious imported brands are growing 10% a year. Distilled spirits are in a nose dive, yet specialty items like Maker's Mark bourbon—$11 a bottle—are thriving. In the face of chronically falling cigarette consumption, R.J. Reynolds is testing Ritz, a "designer" brand supposedly fashioned by Yves Saint Laurent, at premium prices. The chief drawback of the prestige niche is that it's too small to ensure growth for the major industries affected by the new abstinence.

A more common way in which distressed companies are fighting back at declining consumption is with the venerable technique of changing their spiels. The product may be the same as always, but now consumers are told—perhaps to their surprise—that it fits right in with their new health-conscious lifestyles. Recognizing that people worry about pork's fat content, for example, the National Pork Producers Council spent $2 million last year pitching the idea that "America, you're leaning on pork." The Beef Association spent $5 million selling the notion that "beef gives strength," while the American Dairy Association finances several campaigns emphasizing the theme of natural goodness and health and is urging dairies to put a "REAL" symbol on their product packages.

Individual companies are up to the same thing. Campbell Soup is becoming a world-



RESEARCH ASSOCIATE *Brian Dumaine*

Alcohol Is Out, Water Is In

Americans may not be eating and drinking less, but they aren't consuming the way they used to. They crave more chicken, for example, and less pork. Bottled-water imbibing is extremely stylish. They're consuming more wine but less liquor and beer. The net effect: consumption of alcohol is down. Most of sugar's plunge results from a shift to corn sweeteners, cheaper than sugar, in soft drinks. Cigarette consumption of 6.1 pounds per adult in 1984 equals about a daily pack and a half for smokers.

ANNUAL CONSUMPTION PER PERSON: CHANGES, 1980-84 (INDEX: 1980 = 100), AND QUANTITIES CONSUMED IN 1984

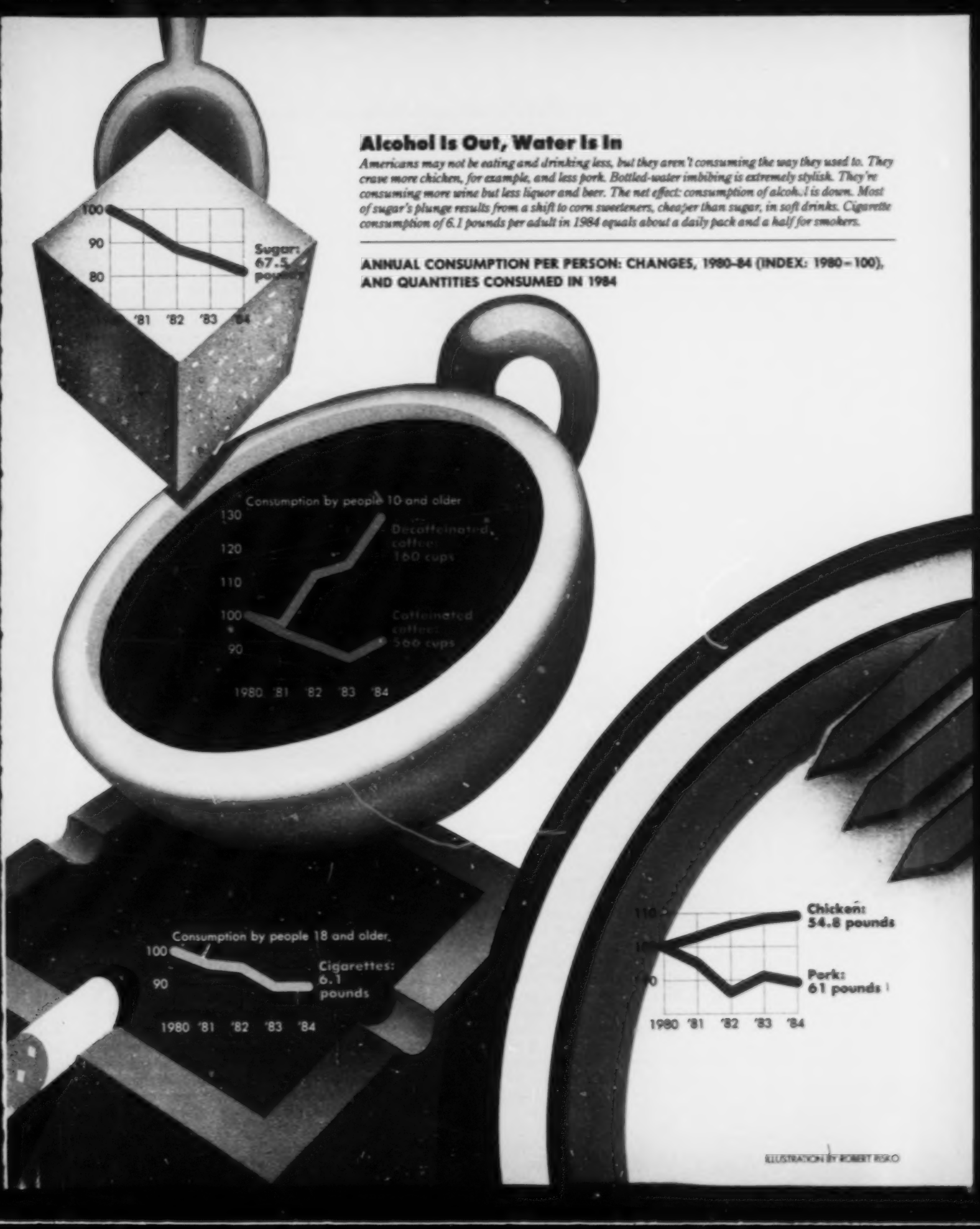


ILLUSTRATION BY ROBERT RISKO

class expert at exploiting consumers' misapprehensions about nutrition, and sales, after years of moderate growth, are now expanding by 12.5% a year. Chief Executive R. Gordon McGovern showed the way by repositioning once stodgy Campbell as a youth-oriented "fitness company." Now print ads for its Swanson's beef and chicken broths, for example, tout "full flavor, few calories, and no caffeine," while showing the body of a slim, scrumptious, and scantily clad young woman. The product sounds great—and of course the ad never mentions that the soup also contains a good deal of sodium, associated with high blood pressure.

Distillers are accentuating the positive too. While alcohol consumption is down overall, wine consumption has risen, and distilled spirits have been the biggest losers. Market research led Bacardi Imports, distributor of Bacardi rum, the best-selling liquor in the U.S., to attribute much of that shift to a misconception: that people can reduce their alcohol intake simply by eschewing the hard stuff. So Bacardi is spending $3 million, 30% of its ad budget, on ads like the one explaining that a rum and orange juice contains no more calories—and less alcohol—than a five-ounce glass of white wine. It may seem odd to claim that a product doesn't contain very much of the thing people used to buy it for, but for liquor marketers today, anything is worth trying.

JUST SENDING UP SMOKE isn't enough for the cigarette business. No other great industry is likely to suffer as much from the new abstinence. Sales at wholesale are $19 billion a year, yet the industry has been so hard hit that even Gerald H. Long, president of R.J. Reynolds Tobacco Co., concedes it is likely to die within a century or two.

Since 1964, when the U.S. Surgeon General first declared smoking hazardous, per capita consumption has plummeted 39%. Even more ominous for the industry's future is the three-point drop over the last decade in smokers as a proportion of the population, 28% last year and still falling. Cigarette makers must fight for a bigger share of this slow-growth business. The result is a proliferation of heavily promoted line extensions of existing brands—new flavors and sizes, for example—and new brands targeted at smaller market segments.

Reduced-tar cigarettes, which boomed in the Seventies, now account for 53% of all cigarettes sold in the U.S. Recently, however, the popularity of the low-tar brands has begun to wane—along with the belief that these less flavorful smokes are also less deadly. Studies show that many smokers of low-tar brands dramatically increase their cigarette consumption, gaining little as a result. As consumers consider this, some figure they may as well go back to smoking higher-tar brands, which taste better. Now cigarette makers are seeking new ways to grow. Liggett & Myers has found one path: it's the top seller of cut-price cigarettes for smokers concerned about price. Other makers are targeting young women—one of the few demographic groups in which smoking is on the rise.

Restrictions on smoking *are spreading, but workers at Campbell Soup in Camden, New Jersey, have long had to leave their desks to light up. No one knows the productivity cost of such rules.*

The liquor industry is under siege not only in the marketplace but also in legislatures. Not since Prohibition have such tough liquor laws been passed—over 360, mainly drunk-driving laws, since 1981. In a deficit-cutting step supported by the new temperance movement, federal excise taxes on hard liquor are due to increase 19% in October. Federal, state, and local taxes already account for 44% of the average retail price of a fifth of liquor, and John C. Maxwell Jr., publisher of the *Maxwell Report* newsletter, estimates the increase will dampen industry sales by 5%. In response to the anti-drunk-driving movement, a federal law will reduce highway funds to any state whose legal drinking age remains below 21 by October 1986. If all states opt for the higher age, says Steve Barsby, a liquor industry consultant, the revenue loss for beer makers alone could amount to $82 million a year. Grouses Edgar Bronfman Jr., 29, president of the House of Seagram, the arm of Joseph E. Seagram & Sons that markets spirits in the U.S.: "The *driving* age is what they should raise to 21."

So called dram-shop laws, which hold bars, package stores, and restaurants liable for serving drinks to people who then crash their cars while intoxicated, have already spread to 23 states. In New Jersey that liability was extended last year even to private individuals. As a result of this and a police crackdown on drunk driving, liquor sales in New Jersey dropped 4% during the peak selling season of November and December last year. To combat critics, the distillers have fashioned a sensible policy of political damage control. Soon after drunk driving captured public attention in 1980, distillers decided to make the issue their own. Liquor companies spent $50 million on moderation messages last year, up from $15 million in 1979.

Nearly all distillers have voluntarily abstained from advertising over the air since the repeal of Prohibition. Now brewers and wine makers, who spend $700 million a year on broadcast ads, are threatened with a mandatory ban pushed by a citizens' group called Project SMART (Stop Marketing Alcohol on Radio and Television). Broadcasters would

suffer most if that happened. Beer and wine makers could shift to other media, just as cigarette companies have done. The broadcasters have reacted with a surge in free public-service announcements warning against drunk driving in recent months. "We're scrambling to get those announcements on the air," admits one network executive.

In the meantime the marketers of liquor, wine, and beer have come up with a dizzying array of products in response to changing tastes. Riunite wine is trying to tag along with the fitness craze by offering jogging gear to buyers of its imported wines. Hiram Walker is hitting faddish boomers where they live by introducing low-alcohol Häagen-Dazs cream drinks, named after the expensive ice cream. Several producers, aiming at women and inexperienced drinkers, are introducing liquor that tastes less like liquor, such as Seagram's vanilla-and-nutmeg-flavored Captain Morgans Spiced Rum. Heublein, a division of R.J. Reynolds, is considering marketing a low-alcohol vodka. Wine producers have increased their good fortunes with wine coolers such as California Cooler and Sun Country. These carbonated flavored drinks, containing half the alcohol of regular wine, now account for 4% of domestic wine's sales—and all of its growth. Seagram is even testing a *no*-alcohol wine called St.Regis.

The brewers, suffering along with the distillers from declining per capita consumption, face similar challenges that require a different marketing approach. An early response, in the mid-1970s, was the introduction of light beers for the diet generation. They took off almost immediately and now constitute 36% of the total market. But low-alcohol brews such as Anheuser-Busch's LA, which seemed immensely promising when introduced, haven't lived up to expectations, and security analysts expect some me-too brands to desert the market soon. Sales of no-alcohol beers like Swiss-made Moussy, though increasing fast, are still minuscule. Explains Joseph Frazzano, an analyst at Oppenheimer & Co.: "Let's face it, a lot of people drink beer to get a buzz."

Abstinence has not damaged sales in America's booming $23-billion-a-year (at wholesale) soft-drink industry—but margins have been severely eroded, largely by increased promotional expenses. Diet soft-drink sales in bars are rising as young people switch away from alcoholic drinks. Traditional soft drinks are still selling well—but diet drinks are where the supergrowth is. According to *Beverage Digest*, an industry newsletter, they already account for 32% of the market, and sales are expanding at a 20% annual rate. G.D. Searle's aspartame, the diet sweetener of choice these days, brought Searle $585 million in 1984 revenues and sweetens a variety of products besides soda, including—imagine—chocolate milk shakes.

Soft drinks without caffeine haven't become the craze that some forecast. But caffeine worries have hurt the coffee industry: it has suffered a 2% drop in per capita consumption since 1980. This has occurred despite a 32% drop in retail coffee prices since 1977, a dramatic rise in sales of caffeine-free coffee products, and a report by the Food and Drug Administration last year that coffee consumed in moderate amounts (about 3½ cups a day) isn't a public health hazard. The situation led the National Coffee Association to launch new advertising on TV a year ago. That campaign pushed the less than credible claim that coffee calms people down; it was quickly reworked.

These days most coffee sellers, seeing growth at the high end of the market, are emphasizing quality and choice. Market research justifies that approach, since ambitious yuppies are leading a trend away from instants to more flavorful grinds. And in the hotly contested decaf sector of the market—now 22% of consumption, compared with 17% five years ago—the biggest winner is General Foods' old reliable Sanka, with a 1984 share of 10%.

The dairy industry, where sales have been flat, has been whiplashed by the twin concerns of obesity and the relation of cholesterol intake to heart disease. But as the swelling sales of cheese demonstrate, consumers may not understand the problem. Plenty of opportunity for marketers remains. As one might expect, lower-fat products are one of the fastest-growing segments of the dairy business; low-fat milk and yogurt are booming. Nonetheless, the American Dairy Association has recognized that the "natural goodness" of all its products is marketable. The group is running ads, such as one for "cheese, glorious cheese," that stress youth-oriented themes and simply ignore the cholesterol problem.

JOHN HAGEN

Real men do drink white wine, *among them this group at the Hayes Street Grill in San Francisco. Wine is the only major alcoholic beverage enjoying increased consumption.*

AT CENTER STAGE on the dinner table, pork consumption is decidedly down, and beef sales are holding steady—after a 19% drop in the late Seventies—mostly because of a shift to leaner cuts. Per capita consumption of chicken is up 9% since 1980. Chicken is lower in calories and has less fat than beef, but simple economics explains much of the shift. Chicken costs less than half as much per pound as beef, in part because of cost-saving automation that beef packers can't match.

The best news from all the confusion in the market is that expert salesmanship still works. One of the largest factors in chicken's gain is the popularity of McDonald's Corp.'s Chicken McNuggets. Each deep-fried McNugget contains 50 calories and plenty of fat. The product has hatched scores of imitators and has rekindled excitement about McDonald's prospects—proof, if any is needed, that a well-crafted pitch still works, even on America's new abstainers. ■